

GAO

**Briefing Report to the Chairman,
Committee on Banking, Finance, and
Urban Affairs, House of
Representatives**

July 1989

TROUBLED THRIFTS

**Use of Supervisory
Enforcement Actions**





General Government Division

B-221644

July 19, 1989

The Honorable Henry B. Gonzalez
Chairman, Committee on Banking,
Finance, and Urban Affairs
House of Representatives

Dear Mr. Chairman:

This briefing report responds to your request for information on the effectiveness of Federal Home Loan Bank Board (FHLBB) supervisory enforcement actions.¹ By effectiveness we mean that the actions prevented or corrected the targeted violations of laws or regulations, or the unsafe or unsound practices.

Because of your urgent need for information this week, we are providing our results to date in the form of two summary tables. These tables provide data on the effectiveness of enforcement actions used and on the length of time taken for enforcement actions. The short time frames for our work did not allow us to fully determine the reasons why certain enforcement actions were ineffective or were not taken in a more timely manner. Furthermore, because of our sampling methodology, the results contained in this report cannot be generalized to reach conclusions about the overall effectiveness of FHLBB supervisory actions.

APPROACH

We analyzed in detail 47 thrifts supervised by the Chicago, Dallas, and San Francisco Federal Home Loan Banks (FHLBanks) and designated as near-failing as of June 1987. We defined near-failing thrifts as those reported by the FHLBanks to be Significant Supervisory Cases (SSCs). These are institutions that (1) depending upon asset size, are within 6 months or within 12 months of insolvency on the basis of earnings trends and/or asset deterioration; (2) have significant problems that will require some form of external resolution within 6 months or within 12 months depending upon asset size, on the basis of the same criteria; or (3) have any problem of which FHLBB should be made aware.

We selected the largest SSCs, in terms of asset size,

¹In a preliminary report, Troubled Thrifts: Bank Board Use of Enforcement Actions (GAO/GGD-89-68BR, Apr. 13, 1989), we presented material on the use of formal enforcement actions.

supervised by each FHLBank, for a total of 47.² These 47 thrifts had combined assets exceeding \$85 billion, accounting for over 80 percent of the total assets of near-failing thrifts supervised by the 3 FHLBanks.

We assessed the formal and informal enforcement actions used in the 47 thrifts between January 1986 and December 1988. Formal enforcement actions discussed in this report, such as cease and desist orders, are provided for by statute and may be taken administratively with an opportunity for judicial review in contested cases. They are typically recommended by the Federal Home Loan Banks (FHLBanks), processed by FHLBB's Office of Enforcement, and approved by the Board itself or, in certain circumstances since its establishment, FHLBB's Enforcement Review Committee. They often are used after other informal supervisory actions have not resulted in the correction of problems. Informal actions, such as supervisory agreements, are generally less severe and can be taken at the FHLBank level. These actions are to be used in instances when potential financial harm is only slight and it is considered likely that management will be responsive. Enforcement actions discussed in this report are explained in the glossary.

For each of the 47 cases, we reviewed relevant documents, including examination reports and enforcement-related memoranda, and interviewed officials at the FHLBanks and FHLBB's Office of Regulatory Activities and Office of Enforcement.

Effectiveness was assessed in terms of whether or not the action taken achieved its intended purpose of getting thrift management to substantially address noted violations or unsafe or unsound practices, thereby preventing losses related to the continuation of violations or practices that might result in financial harm.

In reaching conclusions about the effectiveness of a particular enforcement action, we first reviewed the examination reports of each thrift in our sample to

²Before selecting the SSC thrifts for our sample, we excluded SSCs that were also, as of June 1987, in the Federal Savings and Loan Insurance Corporation (FSLIC) caseload (FSLIC Cases) or the Management Consignment Program (MCP) because such thrifts were not, generally speaking, expected to recover or were under FSLIC-appointed management.

determine when a problem was first reported. We then reviewed the supervisory history to determine when an action was taken and the nature of the action. These actions generally specify corrective actions and may impose operating restrictions. We then reviewed the subsequent supervisory records, including examination reports, to determine compliance. If the problem was not corrected, or the terms were not complied with, the action was considered ineffective; if it was corrected or complied with, the action was considered effective.

The following examples illustrate how we reached conclusions about the effectiveness of specific actions.

- A supervisory directive letter was issued to a thrift in 1986 imposing operating restrictions because of unsafe and unsound practices and violation of regulations. An examination in 1987 found that the restrictions were not being followed and that the practices and violations were continuing. A 1988 cease and desist action ordered the thrift to stop the violations. The subsequent exam concluded that the unsafe and unsound practices were continuing; FHLBank officials told us the cease and desist order was being violated. We assessed the 1986 letter and the 1988 cease and desist order as not effective.
- A 1986 examination report found that a thrift's lending practices were in violation of a prior supervisory agreement. An updated supervisory agreement was concluded in 1987. Supervisory records in 1988 showed that the thrift was violating the 1987 agreement. We assessed the 1987 agreement as not effective.

FINDINGS

FHLBB has stated that violations of laws or regulations and unsafe or unsound practices will not be tolerated and will result in the initiation of strong supervisory and/or enforcement actions. FHLBB's goal is to minimize and, where possible, to prevent losses occasioned by violations or unsafe or unsound practices by taking prompt and effective action.

The effectiveness of actions taken at the 47 near-failing thrifts between January 1986 and December 1988 is shown in table 1. The results in the table indicate that the actions taken were not always effective in preventing or correcting the violations or unsafe or unsound practices.

Table 1:

Effectiveness of Enforcement Actions Taken
at the 47 Near-failing Thrifts
Between January 1986 and December 1988^a

<u>Formal actions</u>	<u>Number</u>	<u>Effectiveness:</u>		
		<u>Yes</u>	<u>No</u>	<u>Could not Determine</u>
Cease and desist order	12	5	7	0
Removal and prohibition order	<u>5</u>	<u>5</u>	<u>0</u>	<u>0</u>
Total	<u>17</u>	<u>10</u>	<u>7</u>	<u>0</u>
<u>Informal actions</u>				
Supervisory agreement	13	5	7	1
Supervisory letter	92	37	39	16
Directive letter	<u>80</u>	<u>35</u>	<u>31</u>	<u>14</u>
Total	<u>185</u>	<u>77</u>	<u>77</u>	<u>31</u>

Source: GAO analysis of FHLBB supervisory records and discussions with FHLBank and FHLBB officials.

^a Consent merger agreements and receivership/conservatorship actions have been excluded because our analysis was not completed.

We also looked at the length of time it took to issue five types of enforcement actions used at the 47 thrifts in our sample. The results are presented in table 2. For informal actions, the elapsed time was measured from the time a problem was first identified and officially documented to the time of action. For formal actions, elapsed time was measured from first identification of a problem or unsuccessful informal action to the time the action was taken. The table notes, where applicable, FHLBB guidance as to appropriate timeframes.

Table 2:

Timeliness of Enforcement Actions
at the 47 Near-failing Thrifts
Between January 1986 and December 1988

<u>Formal actions</u>	Number of actions measured ^a	FHLBB timeframe guidance	<u>Elapsed time in months</u>	
			<u>Average</u>	<u>Range</u>
Cease and desist order	12	none	12.8	1.7 to 36.8
Removal and prohibition order	5	none	15.9	6.2 to 31.9
<u>Informal actions</u>				
Supervisory agreement	13	none	13.1	3.1 to 42.8
Supervisory letter	41	30 days after exam	2.6	0.2 to 9.1
Consent merger agreement:		within 6 months of insolvency		
Actions taken before insolvency	13		3.5	0.0 to 15.8
Actions taken after insolvency	16		5.1	0.3 to 23.5

Source: GAO analysis of FHLBB supervisory records and discussions with FHLBank and FHLBB officials.

^a Supervisory directive letters and receivership/conservatorship actions were excluded because our analysis was not completed. Six supervisory letters and one removal and prohibition order were excluded because we could not measure elapsed time.

VIEWS OF AGENCY OFFICIALS

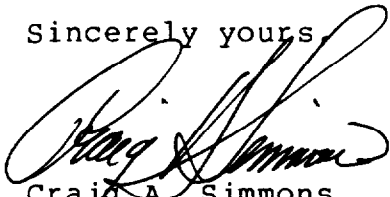
We provided a draft of this report to FHLBB for comments. The Director of the Office of Regulatory Affairs, speaking informally for FHLBB, provided us with informal observations. He said that our review of enforcement actions taken at the 47 thrifts should not be construed to be reflective of the FHLBank system as a whole. Our report explains our selection methodology and cautions that the results cannot be generalized to all thrifts. He also expressed concern that because our work was not complete, the data presented were preliminary.

The official recognized that FSLIC's present condition is indicative of severe regulatory failure but said that our report does not reflect recent changes or the current philosophical approach. He added that FHLBB and the FHLBanks are using opportunities provided by the pending Financial Institutions Reform, Recovery and Enforcement Act to reshape and improve the agency to create the strongest regulatory agency possible. We strongly encourage improvements in this area.

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The major contributors to this report are listed in appendix I. If you have questions, please call me on 275-8678.

Sincerely yours,



Craig A. Simmons
Director, Financial Institutions
and Markets Issues

MAJOR CONTRIBUTORS TO THIS REPORT

GENERAL GOVERNMENT DIVISION,
WASHINGTON, D.C.

Alison L. Kern, Assistant Director
Thomas L. Conahan, Evaluator

CHICAGO REGIONAL OFFICE

Joseph A. Nichols, Senior Evaluator
Barbara Mulliken, Evaluator

DALLAS REGIONAL OFFICE

John V. Kelly, Evaluator

SAN FRANCISCO REGIONAL OFFICE

Benny W. Lee, Evaluator-in-Charge
Belinda F. Jones, Evaluator
Nancy A. Cosentino, Evaluator

GLOSSARY

Cease and desist order (formal action)

FHLBB can issue a cease and desist order when any violation of laws and regulations occurs, any unsafe or unsound practice is conducted, or a written supervisory agreement is not honored. FHLBB can also issue a cease and desist order if it has reasonable cause to believe that such a practice or violation is about to occur. This action is provided for by statute and may be taken administratively, with an opportunity for judicial review in contested cases. (12 U.S.C. 1464(d)(2), 12 U.S.C. 1730(e).)

Civil money penalty (formal action)

FHLBB can assess a civil money penalty against any insured institution, officer, director, employee, agent, or other person participating in the affairs of the institution. FHLBB can assess these penalties for violating the terms of a cease and desist order or monetary transaction record keeping and report requirements. FHLBB can assess the penalty for each day the violation continues; the amount of the fine is at FHLBB's discretion, up to \$1,000 a day. Imposition of civil money penalties is subject to judicial review. (12 U.S.C. 1464(d)(8)(B)(i), 12 U.S.C. 1730(k)(3)(A). FHLBB may also assess a civil money penalty of not more than \$10,000 per day against any person who willfully violates the Change of Control Act. (12 U.S.C. 1730(q)(18).)

Consent merger agreement (informal action)

This is a type of supervisory agreement with which the supervisory agent can (1) ensure the cooperation of the institution's management in searching for a merger partner for the institution and (2) impose operating restrictions on the institution.

Enforcement actions

These actions are tools FHLBB uses to achieve its supervisory and enforcement objectives. There are formal and informal enforcement actions (discussed below). FHLBB uses enforcement actions to minimize and, where possible, to prevent losses due to violations or to unsafe or unsound practices. Enforcement actions are intended to prevent the continuation of violations or practices that may result in financial harm to the institution, its customers, or the FSLIC before such harm actually has resulted.

Enforcement Review Committee

FHLBB established this committee in December 1987, to consider issues of enforcement and supervisory policy and actions to be taken by FHLBB. It consists of the Executive Director of the Office of Regulatory Activities, the FHLBB's General Counsel, the Executive Director for Public Affairs, the Director of the Office of Enforcement, and a Principal Supervisory Agent from a Federal Home Loan Bank to be named on a rotating basis. The Executive Director of the Office of Regulatory Activities, the General Counsel, and the Principal Supervisory Agent are the voting members of the committee.

Federal Home Loan Bank

The Federal Home Loan Bank System is divided into 12 districts. Each district has a Federal Home Loan Bank, sometimes called a district bank. These banks are responsible for providing thrift institutions with the funds to finance home ownership and for examining and supervising their member institutions.

Federal Home Loan Bank Board (FHLBB)

The Federal Home Loan Act of 1932 (12 U.S.C. 1421 et. seq.) established FHLBB as an independent agency in the executive branch. Comprised of a chairman and two members appointed by the President and confirmed by the Senate, FHLBB is responsible for, among other things, regulating and supervising all federally chartered thrift institutions and, in conjunction with state agencies, the state-chartered thrifts insured by FSLIC.

Formal action

A formal enforcement action must be issued by FHLBB or by the Enforcement Review Committee, to which FHLBB has delegated authority to approve uncontested enforcement actions. The Office of Enforcement is responsible for preparing FHLBB's position on formal enforcement actions.

Informal action

An informal action is an action that is issued by a FHLBank; it does not require the approval of FHLBB, the Enforcement Review Committee, or the involvement of Office of Enforcement. It is handled by the supervisory agent.

Office of Enforcement

This office oversees the FHLBB's issuance of formal

enforcement actions against institutions. It assembles and prepares the facts of the case for FHLBB or Enforcement Review Committee, to assist them in deciding whether to issue a formal enforcement action. It also serves as legal counsel to the supervisory agents in Federal Home Loan Banks and to the Office of Regulatory Activities.

Office of Regulatory Activities

The Office of Regulatory Activities oversees FHLBB's examination and supervision functions on a national level.

Principal supervisory agent

A Federal Home Loan Bank president usually serves as the principal supervisory agent in a district. FHLBB must approve the president in his/her regulatory role as Principal Supervisory Agent, even though he/she is appointed by each Federal Home Loan Bank's board of directors.

Receivership (formal action)

When FHLBB declares an institution insolvent, it places the thrift institution into FSLIC receivership, transferring to FSLIC the responsibility for managing the thrift. (12 U.S.C. 1464(d), 12 U.S.C. 1729(c).)

Removal and/or prohibition order (formal action)

This order, issued against officers, directors, and persons participating in the conduct of the affairs of insured institutions, will remove them from office in the institution and/or prohibit their further participation. For example, FHLBB can issue such an order against these individuals if they violate laws, regulations, or a cease and desist order, or if they breach their fiduciary duty in such a way that it will or has caused the institution to suffer losses or other damage. The individual's actions should evidence either personal dishonesty or a willful or continuing disregard for the safety or soundness of the institution. This action is provided for by statute and may be taken administratively with an opportunity for judicial review in contested cases. (12 U.S.C. 1464(d)(4)(1982), 12 U.S.C. 1730(g)(1982).)

Supervisory agent

Supervisory agents, working out of the Federal Home Loan Banks, monitor the condition of member thrifts. They are responsible for providing day-to-day oversight and for initiating corrective measures at the thrifts.

Supervisory agreement (informal action)

The supervisory agent at a FHLBank has the authority to negotiate and execute supervisory agreements, the provisions of which can be extremely broad. Supervisory agreements may require the cessation of any statutory or regulatory violation or unsafe or unsound practice, and they may require affirmative corrective actions to address existing violations, management or operational deficiencies, or any other unsound practices. Supervisory agreements are not enforceable in court. Violation of a supervisory agreement provides grounds for a cease and desist order.

Supervisory directive letter (informal action)

Also known as a directive letter, a supervisory directive letter is a letter from the supervisory agent to the board of directors of an insured institution (1) describing a regulatory violation or other matter of supervisory concern, (2) directing the board to correct the violation or concern, and (3) imposing temporary operating restrictions to alleviate the risks posed by the violation or concern.

Supervisory letter (informal action)

A supervisory letter transmits the report of examination. The supervisory letter covers all matters that the supervisory agent feels must be brought to the attention of the institution's board of directors, rather than being restricted to a discussion of the examination report.

Temporary cease and desist order (formal action)

While proceedings for a permanent cease and desist order are pending (a notice of charges has been issued), FHLBB can issue a temporary cease and desist order if it determines that the violation or unsafe or unsound practice, or the threatened violation or practice, is likely to have substantial adverse effect on the thrift's financial condition before the permanent cease and desist order is issued. The Bank Board can issue a temporary order requiring the thrift to stop the violation or practice. (12 U.S.C. 1464(d)(3)(A), 12 U.S.C. 1730(f)(1).)

Temporary suspensions (formal action)

Temporary suspensions, issued by written notice by FHLBB, immediately relieve an individual from a position with an institution while a case for a removal and prohibition is pending. FHLBB can issue an immediate suspension if it determines that the suspension is necessary to protect the interests of the insured institution until a final decision

is rendered on the notice of removal and prohibition. The individual against whom the suspension is issued may apply to district court within 10 days of the suspension for an injunction or a stay of the suspension. (12 U.S.C. 1464(d)(4)(F), 1730(g)(6).)

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